TRADE-BASED MONEY LAUNDERING IN INTERNATIONAL FINANCE: LEGAL LOOPHOLES, REGULATORY CHALLENGES AND THE ROLE OF TRADE FINANCE

by

Kiransmitha E[1]

ABSTRACT

Trade-Based Money Laundering (TBML) disguises the proceeds of crime through legitimate cross-border trade by employing techniques such as over-invoicing, under-invoicing, multiple invoicing, phantom shipments, and misdescription of goods. Opaque corporate structures and divergent national regulatory frameworks further complicate its detection. Adopting a doctrinal approach, this article critically examines India's legal framework for combating TBML under the Prevention of Money Laundering Act, 2002, the Foreign Exchange Management Act, 1999, the Customs Act, 1962, and applicable banking regulations, with reference to relevant Financial Action Task Force (FATF) standards. It identifies key regulatory weaknesses, including fragmented institutional oversight, difficulties in tracing ultimate beneficial ownership, reliance on trade documentation, and limitations in cross-border enforcement. The article also examines the dual role of trade finance instruments, particularly letters of credit and documentary collections, which facilitate international commerce but may also be exploited to legitimise suspicious transactions. It argues that statutory provisions alone are insufficient to address TBML effectively. An integrated, risk-based regulatory approach is necessary, incorporating coordinated enforcement, improved inter-agency information sharing, technology-assisted trade monitoring, greater corporate transparency, and stronger international cooperation.

Keywords: Trade-Based Money Laundering; International Finance; Prevention of Money Laundering Act, 2002; Trade Finance; Beneficial Ownership.

[1] LL.M., II Year, School of Excellence in Law, The Tamil Nadu Dr. Ambedkar Law University.

Indian Journal of Law and Jurisprudence | Licensed under Creative Commons — https://creativecommons.org/licenses/by/4.0/ | DOI: 10.5281/zenodo.23859566 | Title: Trade-Based Money Laundering in International Finance: Legal Loopholes, Regulatory Challenges and the Role of Trade Fina

1. INTRODUCTION

International trade is an essential component of the global economy. It enables businesses to access foreign markets, obtain raw materials, and participate in international supply chains, and it is supported by financial institutions, trade documentation, foreign exchange arrangements, and specialised trade finance instruments. However, the same complexity that facilitates legitimate transactions may also create opportunities for financial crime. One significant threat is Trade-Based Money Laundering (TBML), through which international trade transactions are manipulated to disguise, transfer, or conceal the proceeds of unlawful activities.

Money laundering is traditionally explained through three analytical stages: placement, layering, and integration. TBML can serve several of these functions at once, because the laundering mechanism is embedded in the trade transaction itself. The goods may be legally traded, the parties may be registered businesses, and payments may pass through regulated banking channels, yet the transaction may involve manipulated prices, fictitious shipments, inaccurate descriptions, or payments unrelated to the movement of goods. The objective is to disguise the movement of value by making it appear to arise from genuine commercial activity.

TBML presents particular challenges for India because a single trade transaction may engage several legal frameworks at once: the Prevention of Money Laundering Act, 2002 (PMLA), the Foreign Exchange Management Act, 1999 (FEMA), the Customs Act, 1962, and the anti-money-laundering obligations that the Reserve Bank of India (RBI) imposes on regulated entities. These frameworks serve different but interconnected purposes.

The existence of these laws does not, by itself, establish that the system is effective against every form of TBML. The challenge lies in connecting commercial documents, physical goods, declared values, payment flows, corporate ownership, and the source of funds. Information relevant to one transaction may be spread across banks, customs authorities, financial intelligence bodies, tax authorities, enforcement agencies, and foreign jurisdictions, and a suspicious pattern may become apparent only when these pieces are examined together.

This article adopts a doctrinal approach to critically examine India's legal and regulatory response to TBML, with reference to the relevant standards of the Financial Action Task Force (FATF). It analyses the principal methods of TBML, the legal framework governing the relevant conduct, the dual role of trade finance, and the institutional challenges affecting detection and enforcement. It argues that the central weakness is not simply an absence of legislation but the difficulty of applying multiple regulatory frameworks coherently to

complex cross-border transactions. An integrated, risk-based system supported by information sharing, beneficial ownership transparency, and technology-assisted monitoring is therefore necessary to strengthen India's response.

2. CONCEPT AND TECHNIQUES OF TRADE-BASED MONEY LAUNDERING

2.1 Meaning and Nature of TBML

Trade-Based Money Laundering refers to the use of trade transactions to move or disguise the proceeds of crime through the deliberate misrepresentation of the price, quantity, quality, description, or existence of goods and services. The FATF has identified trade transactions as a means through which criminals can exploit the international trading system to move value and conceal its illicit origin.[2]

TBML should not be confused with every customs violation, inaccurate invoice, or irregular import payment. Commercial disputes, administrative mistakes, exchange-rate differences, changes in market conditions, and genuine valuation disagreements may produce inconsistencies without establishing money laundering. The defining concern is whether trade is being deliberately manipulated as part of an arrangement to conceal or transfer illicit value or to facilitate another unlawful objective.

TBML can also overlap with other offences, including fraud, tax evasion, customs violations, corruption, and violations of foreign exchange regulations. However, these offences are not interchangeable. Conduct that violates customs or foreign exchange rules does not automatically satisfy the statutory requirements for money laundering under the PMLA. Establishing liability requires examination of the applicable statutory elements and the available evidence.

2.2 Over-Invoicing

Over-invoicing occurs when the declared price of goods or services exceeds their genuine commercial value. An importer may knowingly pay more than the actual value of imported goods, allowing additional funds to be transferred to a foreign seller or associated entity.

For instance, if machinery worth ₹2 crore is invoiced at ₹10 crore, the inflated payment may transfer an additional ₹8 crore through the apparent import transaction. Where the

[2] Financial Action Task Force & Egmont Group of Financial Intelligence Units, Trade-Based Money Laundering: Trends and Developments (2020).

arrangement is deliberately structured to conceal or move illicit value, it may constitute part of a TBML scheme.

Over-invoicing can be difficult to identify because prices are not always uniform. Product specifications, insurance, freight, warranties, intellectual property, and contractual conditions can affect commercial value. Consequently, an unusual price should be treated as a risk indicator requiring examination rather than conclusive proof of criminal conduct.

2.3 Under-Invoicing

Under-invoicing involves declaring a value lower than the actual transaction value. An exporter may report goods worth ₹10 crore as worth ₹4 crore, leaving part of the actual value unrecorded in the declared transaction.

Under-invoicing may be associated with customs duty evasion, tax evasion, or the concealment of the true proceeds of a transaction. Its significance for TBML depends on the wider arrangement, including the movement of funds, the identity of the parties, and the purpose of the misrepresentation.

It is therefore necessary to distinguish the customs consequences of an inaccurate declaration from the separate question of whether the conduct forms part of a money-laundering operation.

2.4 Multiple Invoicing

Multiple invoicing involves using more than one invoice to obtain payment for the same shipment or transaction. A party may present duplicate or inconsistent invoices to different financial institutions or use them to support repeated claims for payment.

The practice can create uncertainty regarding the actual value and payment status of goods. It may also allow a trader to obtain financing or transfer funds more than once against the same commercial transaction.

Effective verification requires comparison of invoice details with shipping records, transport documents, payment instructions, and the records of other financial institutions where lawfully accessible.

2.5 Phantom Shipments

Phantom shipments involve transactions in which goods are falsely represented as having been exported or imported even though the claimed movement did not occur. A business may

submit fabricated commercial invoices and supporting documents to obtain payment or move funds abroad under the appearance of a genuine import or export.

Advance import remittances can create particular risks where foreign exchange is transferred before the goods arrive. Such remittances are not inherently suspicious because advance payment is a legitimate commercial practice. The risk arises when the claimed import is fictitious, the supporting documents are fabricated, or the transaction is structured to divert funds without a genuine commercial basis.

Investigating phantom shipments requires more than checking whether a payment has been processed. Authorities may need to examine customs declarations, transport records, shipment tracking information, foreign counterparties, and whether the goods were actually delivered.

2.6 Misdescription and Quantity Manipulation

Misdescription occurs when goods are deliberately described inaccurately to conceal their nature, quality, or value. A transaction may involve declaring a high-value product as a lower-value item, misrepresenting the grade of a commodity, or describing synthetic goods as natural products.

Quantity manipulation involves declaring more or fewer goods than were actually shipped. These techniques can be combined with over-invoicing or under-invoicing to disguise the true value of a transaction.

The difficulty is particularly pronounced in commodities and goods whose prices depend on quality, grade, origin, or technical specifications. Effective verification may require specialist knowledge, independent valuation, physical inspection, laboratory testing, or reliable market data.

2.7 Complex Third-Party Transactions

TBML may involve several companies, intermediaries, and jurisdictions. Payments may be made by an entity that is not the importer, while the goods are shipped to a different party. Corporate structures may include shell companies, front companies, or entities whose beneficial owners are difficult to identify.

Third-party payments and multi-party supply chains are not inherently unlawful. International trade frequently involves agents, distributors, factoring arrangements, centralised treasury functions, and complex contractual relationships. The concern arises where the arrangement lacks a credible commercial explanation, obscures the actual beneficiary, or forms part of a pattern intended to conceal illicit value.

FATF risk indicators emphasise that individual indicators should be assessed in context.[3] A single unusual feature does not necessarily establish TBML; several connected indicators may justify enhanced examination.

3. INDIA'S LEGAL AND REGULATORY FRAMEWORK

3.1 Prevention of Money Laundering Act, 2002

The PMLA is India's principal legislation for preventing money laundering and addressing property connected with criminal activity. Section 3 defines the offence of money laundering, while Section 4 prescribes punishment.[4] The Act also provides for the attachment and confiscation of property in accordance with its provisions and establishes obligations applicable to reporting entities.

The PMLA is relevant to TBML where the conduct satisfies the statutory requirements for money laundering. Manipulated invoices, fictitious shipments, or unusual foreign remittances may provide evidence of a wider scheme, but the mere existence of a trade irregularity does not automatically establish the offence.

A central concept under the PMLA is proceeds of crime, defined by reference to property derived or obtained, directly or indirectly, as a result of criminal activity relating to a scheduled offence, or the value of such property, as provided by the Act. Accordingly, a TBML investigation must consider the relationship between the suspected property, the alleged criminal activity, and the statutory requirements for money laundering. It is insufficient simply to label a transaction suspicious without establishing the legally relevant connection.

Section 5 provides for provisional attachment of property in circumstances specified by the Act. Sections 17 and 18 concern search and seizure powers, subject to statutory conditions. Section 24 addresses the burden of proof in the circumstances specified by the provision. These provisions may be relevant when investigating trade transactions alleged to conceal or move proceeds of crime, but their application remains governed by the Act and judicial interpretation.

The PMLA also places obligations on reporting entities, including relevant financial institutions, concerning customer identification, record maintenance, and reporting of

[3] Financial Action Task Force, Trade-Based Money Laundering: Risk Indicators (2021).
[4] Prevention of Money Laundering Act, No. 15 of 2003, §§ 3–5, 17–18, 24 (India).

prescribed information. The Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, further regulate these obligations.[5]

For TBML prevention, the value of this framework lies in its ability to connect suspicious financial activity with the underlying criminal conduct. Banks may identify an unusual remittance, but a meaningful investigation may require evidence concerning the goods, the importer, the exporter, and the commercial purpose of the transaction.

A limitation arises when financial institutions detect suspicious patterns but lack access to the relevant customs or shipping information. Conversely, customs authorities may identify unusual declarations without immediately knowing whether the payment originated from criminal proceeds. The effectiveness of the PMLA therefore depends partly on the ability of relevant authorities to exchange and analyse information lawfully.

3.2 Foreign Exchange Management Act, 1999

FEMA regulates foreign exchange transactions and specified cross-border financial activities. It establishes the legal framework for authorised dealings in foreign exchange and provides for compliance with applicable rules, regulations, and directions.[6]

FEMA is relevant to TBML because international trade frequently involves advance remittances, export proceeds, import payments, and foreign currency transfers. Manipulated invoices and fictitious imports may be used to disguise the purpose of outward remittances or to facilitate unauthorised movement of funds.

For example, an entity may remit funds abroad as advance payment for imported machinery, although no genuine import is intended. If the remittance is supported by fabricated documents, the transaction may raise questions under FEMA and other applicable laws. Whether a violation has occurred depends on the particular facts and the applicable regulatory requirements.

FEMA and the PMLA serve different legal purposes. FEMA principally regulates foreign exchange transactions, whereas the PMLA addresses money laundering involving proceeds of crime within the scope of its provisions. A transaction may raise issues under both frameworks, but a FEMA contravention does not automatically establish money laundering under the PMLA.

The practical challenge is that foreign exchange compliance often relies on information submitted by customers and supporting trade documents. Where the underlying commercial

[5] Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (India).
[6] Foreign Exchange Management Act, No. 42 of 1999 (India).

transaction is fictitious or materially misrepresented, documentary compliance alone may not reveal the actual purpose of the transfer.

The response should therefore combine examination of the payment with an assessment of its commercial rationale, the parties involved, the goods allegedly traded, and the available evidence of shipment or delivery.

3.3 Customs Act, 1962

The Customs Act governs the import and export of goods and provides the legal framework for customs declarations, assessment, valuation, and enforcement.[7] It is particularly relevant to TBML because manipulation of the description, quantity, classification, origin, or value of goods may form part of a laundering arrangement.

Customs authorities can examine declarations and supporting records, assess goods in accordance with applicable law, and investigate suspected violations. Accurate customs information may also provide an important source of evidence for financial institutions and other enforcement agencies.

Over-invoicing and under-invoicing are especially relevant where declared values are inconsistent with the actual transaction or where the declared value has been manipulated to facilitate an unlawful transfer of value. However, valuation differences must be examined in context. Differences between market prices and declared transaction values may arise from legitimate commercial factors.

The Customs Act cannot, by itself, address every dimension of TBML. Customs authorities may establish that a declaration is false or that goods have been misdescribed, but the full financial arrangement may involve foreign companies, offshore accounts, or payments made through multiple banks. Determining whether the conduct also amounts to money laundering may require investigation under other legislation.

A coordinated approach is therefore necessary. Customs data can help establish whether goods existed, whether the declared quantity was plausible, and whether the shipment matched the relevant documentation. Banking and financial information can then help identify whether the transaction was used to move or conceal illicit value.

3.4 RBI Regulations and Banking Compliance

Banks and other regulated financial institutions occupy an important position in the prevention and detection of TBML because they process international payments and provide

[7] Customs Act, No. 52 of 1962 (India).

trade finance. Their regulatory obligations include customer due diligence, risk assessment, ongoing monitoring, record keeping, and reporting in accordance with applicable law and RBI directions.

The RBI's Master Direction on Know Your Customer (KYC) establishes requirements relevant to customer identification, beneficial ownership, ongoing due diligence, and monitoring of transactions.[8] The Direction also requires regulated entities to assess money-laundering and terrorist-financing risks and to apply measures proportionate to those risks.

In the context of TBML, banks should assess whether trade-related transactions are consistent with the customer's business profile, expected turnover, financial capacity, and established trading relationships. Transactions lacking an apparent economic rationale, unexpected changes in payment arrangements, unexplained third-party payments, and unusually complex transfers may justify closer scrutiny.

Banks can also examine whether a customer's trading activity corresponds with the expected movement of funds. For example, a newly established company with limited business operations that suddenly makes high-value international remittances to unrelated parties may warrant additional due diligence. Such a pattern is not conclusive evidence of wrongdoing but may require further investigation.

Nevertheless, banks face practical limitations. They may receive invoices, bills of lading, insurance documents, and other trade records without independently verifying every aspect of the physical transaction. A document may appear formally complete even when the goods were never shipped or the stated price is commercially implausible.

Banks should therefore adopt a risk-based approach rather than treating the existence of documentation as sufficient proof of legitimacy. Enhanced examination may be appropriate where the transaction involves unfamiliar counterparties, high-risk jurisdictions, inconsistent documentation, unusual pricing, or payment arrangements that lack a credible commercial explanation.

At the same time, compliance systems must avoid treating every complex transaction as suspicious. Excessive reliance on isolated indicators can lead to unnecessary delays, false positives, and the exclusion of legitimate businesses from financial services. Effective monitoring must balance financial integrity with the need to facilitate lawful commerce.

IJLJ ISSN: 2583-2794

[8] Reserve Bank of India, Master Direction—Know Your Customer (KYC) Direction, 2016, RBI/DBR/2015-16/18 (Feb. 25, 2016, as amended).

3.5 The FATF Framework

The Financial Action Task Force is an intergovernmental body that develops international standards for combating money laundering, terrorist financing, and related threats to the integrity of the financial system. Its recommendations provide an important framework for risk assessment, customer due diligence, beneficial ownership transparency, financial intelligence, and international cooperation.[9]

FATF materials addressing TBML highlight the importance of examining trade transactions in their wider commercial and financial context. Indicators may include inconsistent pricing, unusual payment arrangements, unexplained third-party transactions, complex supply chains, and discrepancies between the customer's stated business activity and actual transaction patterns.

The FATF framework is particularly useful because TBML frequently involves several jurisdictions. A transaction may be arranged in one country, financed through another, and settled through an account in a third. Domestic authorities cannot effectively address every element of such a scheme without appropriate international cooperation.

FATF standards should not, however, be confused with directly applicable domestic criminal provisions. They guide the development and evaluation of anti-money-laundering systems, while liability under Indian law must be determined under the applicable Indian legislation.

The relevance of FATF standards to India lies in their ability to provide a benchmark for evaluating whether the domestic system effectively identifies risks, traces beneficial ownership, shares information, and responds to suspicious cross-border transactions.

4. ROLE OF TRADE FINANCE IN FACILITATING AND PREVENTING TBML

4.1 Trade Finance and International Commerce

Trade finance refers to financial products and arrangements that support domestic and international trade. These include letters of credit, documentary collections, bank guarantees, trade loans, and certain forms of receivables and supply-chain finance.

International trade often involves a gap between the time when goods are shipped and the time when payment is received. Exporters may require payment security, while importers may wish to verify that goods have been shipped before releasing funds. Trade finance instruments help manage these risks and make cross-border commerce more predictable.

[9] Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations (as amended).

The same instruments may, however, be exploited where the underlying trade is fictitious, the documents are manipulated, or the parties deliberately conceal the true nature of the transaction.

4.2 Letters of Credit

A letter of credit is an undertaking by a bank to make payment to a beneficiary when the stipulated documentary conditions are satisfied. It helps reduce the risk that an exporter will not receive payment after complying with the documentary requirements.

Letters of credit can also create vulnerabilities where parties present apparently compliant documents that do not accurately represent the underlying commercial reality. A bank may examine documents in accordance with the terms of the credit and the applicable rules, yet the documents may fail to reveal that goods were misdescribed or that the transaction was deliberately overvalued.

This does not mean that letters of credit inherently facilitate money laundering. They are essential commercial instruments. The risk arises where their documentary structure is exploited to make a suspicious transaction appear legitimate.

4.3 Documentary Collections

Documentary collections involve the transmission of commercial and financial documents through banks, with payment or acceptance arranged according to the collection instructions. Unlike a letter of credit, a documentary collection generally does not provide the same independent payment undertaking by the collecting bank.

Documentary collections can support legitimate trade by reducing the need for direct handling of documents between distant parties. However, the presence of documents does not necessarily establish that the transaction has a legitimate economic purpose.

A collection may involve genuine goods but manipulated values, or it may form part of a larger scheme involving related entities and circular payments. Financial institutions must therefore consider the customer's profile and the transaction's surrounding circumstances rather than relying exclusively on the collection documents.

4.4 The Dual Role of Financial Institutions

Financial institutions can be both potential channels for the movement of illicit value and important safeguards against financial crime. Their access to payment records, customer

information, and transaction histories enables them to identify patterns that may not be visible from an individual invoice.

Effective controls include customer due diligence, beneficial ownership identification, transaction monitoring, sanctions screening, document verification, and the reporting of suspicious transactions where required. Banks can also compare a customer's transaction activity with its known business operations and investigate unexplained changes.

Nevertheless, banks cannot independently verify every physical shipment or establish the accuracy of every declared customs value. Effective prevention therefore requires cooperation between financial institutions and the authorities responsible for customs, foreign exchange, financial intelligence, and criminal enforcement.

The central lesson is that documentary compliance is necessary but not always sufficient. The legitimacy of a transaction must be assessed through a proportionate examination of its commercial purpose, the parties involved, the movement of goods, and the flow of funds.

5. LEGAL LOOPHOLES AND REGULATORY CHALLENGES

5.1 Fragmented Regulatory Oversight

One of the principal challenges in combating TBML is the distribution of regulatory responsibilities across different institutions. The PMLA, FEMA, customs legislation, banking regulations, and tax laws address different aspects of financial and commercial activity. Their coexistence is necessary, but their effective application depends on coordination.

For example, customs authorities may identify a discrepancy in the declared value of imported goods. A bank may separately observe an unusually large outward remittance. A financial intelligence authority may receive information concerning suspicious account activity. If these observations are not connected, the wider pattern may remain undetected.

The problem is not necessarily that the relevant authorities lack legal powers. Rather, the practical challenge lies in ensuring that relevant information reaches the appropriate authority in time and is analysed alongside other evidence.

Regulatory fragmentation can also create uncertainty about responsibility for particular aspects of an investigation. Effective enforcement requires clear procedures for referrals, information exchange, joint analysis, and follow-up action.

IJLJ ISSN: 2583-2794

5.2 Difficulties in Identifying Ultimate Beneficial Ownership

Beneficial ownership refers to the natural person or persons who ultimately own or control a legal entity, directly or indirectly, in accordance with the applicable legal framework. Identifying beneficial owners is important because the person formally named in a corporate document may not be the person exercising effective control or receiving the economic benefit.

TBML schemes may involve companies incorporated in different jurisdictions, nominee arrangements, multiple layers of ownership, or entities with limited genuine business activity. Such structures can make it difficult to determine who controls the transaction and who ultimately benefits from it.

India has legal and regulatory requirements concerning beneficial ownership, including relevant obligations under company law and RBI's KYC framework. Nevertheless, the existence of reporting requirements does not guarantee that information will always be complete, current, easily accessible, or readily comparable across jurisdictions.

Improved beneficial ownership transparency requires reliable information, effective verification, access by competent authorities, and appropriate cooperation between jurisdictions. It must also preserve lawful confidentiality and comply with applicable data-protection requirements.

5.3 Reliance on Trade Documentation

International trade depends heavily on documentary records. Invoices, bills of lading, certificates of origin, insurance documents, packing lists, and customs declarations help establish the terms and movement of goods.

However, documents may be falsified, duplicated, or manipulated. Even genuine documents may contain inaccurate descriptions or fail to reveal the true commercial purpose of a transaction. A document's formal validity does not necessarily prove that the underlying trade occurred exactly as represented.

This creates a particular difficulty for banks because they may have contractual and regulatory duties to examine documents but lack direct access to the physical goods. Customs authorities may have access to shipment information but not necessarily to the complete financial arrangement.

A stronger system would permit lawful comparison of relevant information across documentary, financial, and shipping records. Such comparison should be risk-based and proportionate, avoiding the assumption that every discrepancy demonstrates criminal intent.

IJLJ ISSN: 2583-2794

5.4 Challenges in Establishing Suspicious Pricing

Price discrepancies can be an indicator of TBML, but determining whether a price is suspicious can be difficult. Prices may vary according to quality, grade, volume, origin, contractual terms, delivery conditions, insurance, freight, currency fluctuations, and market timing.

A simple comparison with a publicly available market price may therefore be misleading. A transaction priced above or below a benchmark may have a legitimate commercial explanation.

Effective analysis should consider the nature of the goods, the contractual relationship, comparable transactions, the parties' business profiles, and the circumstances in which the price was agreed. Specialist valuation or technical expertise may be necessary for certain commodities and products.

Regulatory systems should distinguish between a risk indicator and proof of wrongdoing. This distinction is essential both for effective enforcement and for protecting legitimate businesses from unjustified suspicion.

5.5 Cross-Border Enforcement and Information Sharing

TBML frequently involves parties, goods, payments, and corporate entities located in different jurisdictions. Investigators may need information from foreign banks, customs authorities, company registries, shipping providers, or law enforcement agencies.

Differences in legal systems, evidentiary requirements, data-protection rules, and institutional procedures can delay investigations. Information may be available in one country but difficult to obtain or use in another.

International cooperation is therefore central to effective enforcement. Authorities need lawful mechanisms for requesting information, preserving evidence, identifying beneficial owners, tracing assets, and coordinating investigations where appropriate.

International cooperation must also respect due process, confidentiality requirements, and the legal safeguards applicable in each jurisdiction. Speed is important, but information exchange must remain lawful and reliable.

5.6 Limitations of Technology-Assisted Monitoring

Technology can help identify patterns that may be difficult to detect through manual examination. Data analytics may compare declared prices, payment flows, shipment details,

customer profiles, and historical transaction behaviour. Artificial intelligence and machine-learning tools may help prioritise transactions for further review.

However, technology is not a complete solution. Monitoring systems depend on the quality, completeness, and compatibility of the information available to them. If customs data, banking records, and shipping information use incompatible formats or cannot be lawfully exchanged, automated analysis may be limited.

Automated systems can also generate false positives where legitimate transactions differ from historical patterns. Their outputs should therefore support, rather than replace, professional investigation and legal assessment.

Technology-assisted monitoring should be supported by clear governance, data-quality controls, appropriate human oversight, and periodic evaluation of system performance. Decisions with significant legal consequences should not be based solely on an unexplained automated risk score.

5.7 Distinguishing Regulatory Gaps from Absence of Law

It would be inaccurate to suggest that India has no legal framework capable of addressing conduct associated with TBML. The PMLA, FEMA, Customs Act, company law, and banking regulations address several relevant dimensions of the problem.

The more significant concern is whether these frameworks operate effectively together when a transaction involves several agencies and jurisdictions. A law may provide appropriate powers on paper while practical difficulties remain in identifying suspicious activity, exchanging information, establishing beneficial ownership, and coordinating enforcement.

Accordingly, the expression regulatory gaps should be understood primarily as referring to weaknesses in coordination, implementation, detection, and enforcement rather than a complete absence of statutory provisions.

This distinction is important for legal analysis. It directs attention away from merely demanding more legislation and towards evaluating how existing powers and obligations can be applied more effectively.

6. JUDICIAL DECISIONS AND THEIR RELEVANCE

Judicial decisions concerning alleged international trade-based money laundering illustrate the relationship between trade transactions, foreign exchange remittances, documentary evidence, and the PMLA. They must, however, be analysed carefully. An order passed during bail or

revision proceedings is not equivalent to a final conviction, and allegations recorded in a judicial order should not be presented as finally established facts.

In *Mohammed Riyaz v. Deputy Director*, the Madras High Court considered proceedings arising from allegations involving foreign outward remittances and suspected financial irregularities. The allegations concerned the use of a bank account opened under an assumed identity and outward remittances allegedly made without corresponding imports. The proceedings illustrate the potential significance of banking records, corporate arrangements, and the alleged movement of funds through ordinary financial channels. The case is relevant to TBML because apparently commercial transactions may require examination beyond the immediate payment documents.[10]

In *Sidhant Gupta v. Assistant Director*, the Madras High Court considered criminal revision proceedings challenging the rejection of discharge applications in cases involving alleged money laundering. The underlying allegations included substantial outward remittances made in the guise of advance import payments without corresponding imports and transactions allegedly supported by fabricated documents. The proceedings described the alleged activity as international trade-based money laundering.[11]

The case is relevant because it illustrates how the stated purpose of an outward remittance may be compared with evidence of actual imports and the role of the entities involved. The Supreme Court subsequently declined to interfere with the Madras High Court's order and directed that the trial could proceed in accordance with law, while the final judgment in the PMLA proceedings was not to be pronounced until charges were framed in the predicate offence.[12]

These decisions should not be understood as establishing that every advance remittance without a completed import constitutes money laundering. Advance payments can be legitimate, and imports may be delayed or cancelled for genuine commercial reasons. The legal significance depends on the evidence and the applicable statutory requirements, including the connection between the alleged conduct and proceeds of crime.

The broader lesson is that trade-related financial investigations require an examination of the relationship between the stated commercial purpose and the actual movement of goods and

[10] *Mohammed Riyaz v. Deputy Director*, Crl. O.P. No. 4496 of 2021 (Madras High Court Apr. 9, 2021).
[11] *Sidhant Gupta v. Assistant Director*, Crl. R.C. Nos. 71, 115, 116 & 311 of 2024 (Madras High Court Aug. 12, 2024).
[12] *Sidhant Gupta v. Assistant Director, Directorate of Enforcement*, Special Leave to Appeal (Crl.) No. 14392 of 2024 (Supreme Court of India Oct. 22, 2024).

funds. Judicial scrutiny also reinforces the importance of distinguishing allegations, investigative findings, interim procedural decisions, and final determinations of liability.

7. RECOMMENDATIONS AND THE WAY FORWARD

7.1 Strengthening Inter-Agency Coordination

India should strengthen coordination among the authorities responsible for money laundering, foreign exchange, customs, banking supervision, taxation, and financial intelligence. Effective cooperation should include clear procedures for referring suspicious transactions, sharing relevant information lawfully, and coordinating investigations where a transaction raises issues under several legal frameworks.

Coordination does not require all agencies to perform the same functions. Rather, it requires each authority to contribute the information and expertise within its legal mandate. Customs authorities may establish facts about goods and declarations, while banks may provide information concerning payments and account activity. Financial intelligence and enforcement authorities can analyse these elements alongside other evidence.

Clear protocols for inter-agency communication would help reduce duplication, improve the identification of connected transactions, and ensure that important information is not overlooked.

7.2 Improving Beneficial Ownership Transparency

Greater transparency concerning ultimate beneficial ownership is essential to identifying the individuals who control trading entities and benefit from suspicious transactions. Existing disclosure requirements should be supported by effective verification, reliable records, timely updating, and appropriate access by competent authorities.

Where ownership structures involve several jurisdictions, international cooperation is necessary to establish the relationship between the formal legal owner and the person exercising effective control. Authorities should be able to identify unexplained links between trading companies, payment recipients, and other entities involved in a transaction.

At the same time, beneficial ownership information should be handled in accordance with applicable confidentiality, privacy, and data-protection requirements. Transparency should serve legitimate regulatory purposes without creating unnecessary exposure of personal information.

7.3 Enhancing Risk-Based Trade Monitoring

Banks and other relevant institutions should strengthen monitoring of trade-related transactions through risk-based assessment. Factors may include inconsistencies between the customer's business profile and transaction activity, unexplained third-party payments, unusual pricing, repeated transactions involving the same goods, complex payment routes, and discrepancies between payment records and available shipment information.

No single factor should automatically be treated as proof of TBML. Instead, institutions should assess the overall transaction, including the commercial rationale, customer history, counterparties, and supporting documents.

Enhanced due diligence should be directed towards transactions presenting a higher level of risk, while legitimate businesses should continue to have access to efficient trade finance services. A proportionate approach can improve detection without imposing unnecessary burdens on ordinary commerce.

7.4 Integrating Relevant Data

A significant improvement would be the lawful comparison of customs information, trade documents, banking records, shipping data, and other relevant sources. Where permitted, this could help authorities identify repeated invoice use, unexplained differences between declared values and payments, fictitious shipment patterns, and links between otherwise separate transactions.

Data integration should be supported by common standards, secure information systems, clear access controls, and appropriate safeguards against misuse. Information should be shared only for authorised purposes and in accordance with applicable law.

Technology-assisted analysis can help identify suspicious patterns, but findings should be examined by trained personnel who understand the commercial context and relevant legal requirements.

IJLJ
ISSN: 2583-2794

7.5 Improving Trade Finance Compliance

Financial institutions should treat trade finance compliance as an assessment of the overall transaction rather than a purely documentary exercise. Depending on the risk involved, this may require reviewing the customer's business model, the relationship between the parties, the reason for unusual payment arrangements, and the consistency of the available trade records.

Banks should also establish procedures for escalating unusual transactions and documenting the reasons for decisions. Effective staff training is important because trade finance personnel

must understand both the commercial function of trade instruments and the warning signs of financial crime.

Cooperation between banks, exporters, importers, customs authorities, and other competent bodies can strengthen the identification of suspicious transactions while respecting confidentiality and legal obligations.

7.6 Strengthening International Cooperation

Because TBML frequently crosses national borders, India should continue to strengthen cooperation with foreign regulators, financial intelligence units, customs administrations, and law enforcement authorities. Cooperation can assist in verifying foreign counterparties, tracing payments, obtaining evidence, identifying beneficial owners, and pursuing assets where the law permits.

International cooperation should focus on practical outcomes, including timely responses to lawful information requests, compatible information standards, and effective mechanisms for coordinating investigations.

FATF standards provide a useful framework for assessing these efforts. Their effectiveness, however, depends on meaningful implementation and cooperation rather than formal adherence alone.

7.7 Periodic Review of Regulatory Effectiveness

Regulatory effectiveness should be evaluated periodically using indicators such as the timeliness of information exchange, the quality of suspicious transaction reporting, the ability to identify beneficial owners, the detection of connected transactions, and the effectiveness of investigations.

Such evaluation should also consider whether monitoring systems generate excessive false positives and whether legitimate traders experience unnecessary delays. A system that flags large numbers of ordinary transactions without meaningful analysis may create compliance burdens without improving enforcement.

Periodic review can help identify weaknesses in implementation and guide targeted improvements to regulations, institutional procedures, technology, and training.

8. CONCLUSION

Trade-Based Money Laundering presents a complex challenge because it exploits the ordinary mechanisms of international commerce. Unlike schemes that rely exclusively on cash

movements or financial transfers, TBML may use commercial invoices, shipping documents, foreign exchange payments, and trade finance instruments to make the movement of value appear legitimate. The underlying goods may be lawful, the businesses may be formally registered, and the payments may pass through regulated institutions. The suspicious element may lie in the manipulation of the transaction's value, purpose, description, or existence.

India possesses a substantial legal framework relevant to combating TBML. The PMLA addresses money laundering involving proceeds of crime; FEMA regulates foreign exchange transactions; the Customs Act governs the import and export of goods; and RBI regulations establish important obligations for customer due diligence and transaction monitoring. FATF standards provide an international benchmark for evaluating risk assessment, transparency, and cooperation. Nevertheless, the existence of these legal instruments does not automatically ensure that complex trade-based schemes will be detected or effectively investigated.

The central challenge is the interaction between fragmented regulatory responsibilities, limited visibility into beneficial ownership, reliance on documentary evidence, and the cross-border nature of international trade. A bank may identify an unusual payment without knowing whether goods were shipped, while customs authorities may identify an inaccurate declaration without having access to the full financial trail. If these elements are not connected, the wider arrangement may remain difficult to detect.

Trade finance must therefore be understood in its dual role. Instruments such as letters of credit and documentary collections are essential to international commerce, but their documentary structure can be exploited when parties deliberately misrepresent the underlying transaction. Effective prevention requires financial institutions to assess the commercial rationale and wider risk context of transactions rather than relying exclusively on the apparent completeness of documents.

This article argues that India's response should focus not merely on adding statutory provisions but on improving the coordinated operation of existing laws. Stronger inter-agency cooperation, verified beneficial ownership information, risk-based monitoring, secure data integration, technology-assisted analysis, and international collaboration can improve the ability to identify suspicious patterns. Such measures must be implemented proportionately, with appropriate legal safeguards and recognition that unusual commercial activity does not automatically establish criminal conduct.

Ultimately, the effectiveness of a TBML prevention framework depends on its ability to connect the movement of money with the movement of goods and the commercial purpose of the transaction. The key question is not simply whether the documents appear complete, but

whether the transaction makes commercial sense and whether its financial and documentary features are consistent with the available evidence. An integrated, risk-based approach is essential to protect the integrity of India's trade and financial systems while preserving the legitimate benefits of international commerce.

— I J L J —
ISSN: 2583-2794